

Total Control: Corporate Governance, Firm Performance, and Possible Solutions for Reducing Downside Risk in Technology Companies with Dominant CEOs

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ABSTRACT: Creative destruction and the popularity of dual class stock structures have led to a recent increase in chief executives who either control a majority of voting power within the company or exercise de facto control through their considerable influence. Public corporations with such powerful CEOs perform differently from traditional companies in statistically significant and often negative ways. Interestingly, studies show that companies with powerful CEOs in turbulent industries, like the technology sector, experience negative firm performance at higher rates than those in more controlled environments. Additionally, these dominant tech CEOs present a corporate governance challenge, one that has not been properly addressed by lax independence requirements for directors, who are often hand-picked by the dominant CEO and have little incentive to advocate aggressively for shareholder value. Traditional governance safeguards championed by activists and shareholder rights groups are also insufficient because of the dominant CEO's control over the nominating and voting processes. As a result, activists, stock exchanges, regulators, and courts must get involved to minimize the negative aspects of CEO dominance that cannot be properly monitored by the board of directors.

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I. INTRODUCTION

On August 19, 2004, Google (now Alphabet, Inc.) held its initial public offering (“IPO”).¹ The IPO began at a share price of \$85 and raised over \$1.9 billion for the company.² Since its IPO, Google has grown into a worldwide juggernaut, with a peak market cap of over \$900 billion.³ In addition to its great monetary success, Google has left another lasting legacy on the technology sector that is less mainstream, but still vitally important. In its IPO, Google used dual class shares to ensure that its founders, Larry Page and Sergey Brin, retained control over the newly public corporation.⁴ Through this structure, Page and Brin retained over 50 percent of Google’s voting

1. *If You Had Invested Right After Google’s IPO*, INVESTOPEDIA, <https://www.investopedia.com/articles/active-trading/081315/if-you-would-have-invested-right-after-googles-ipo.asp> [<https://perma.cc/U49M-TQRU>] (last updated Aug. 13, 2015).

2. *Id.*

3. *Alphabet Market Cap 2006–2019 | GOOGL*, MACROTRENDS, <https://www.macrotrends.net/stocks/charts/GOOGL/alphabet/market-cap> [<https://perma.cc/NXE9-Y7E6>].

4. John Markoff, *The Google I.P.O.: The Overview; Google’s Sale of Its Shares Will Defy Wall St. Tradition*, N.Y. TIMES (Apr. 30, 2004), <https://www.nytimes.com/2004/04/30/business/google-ipo-overview-google-s-sale-its-shares-will-defy-wall-st-tradition.html> [<https://perma.cc/8YQM-LY5S>].

power, despite owning considerably less than 50 percent of its equity.⁵ In this way, Google was able to reap the benefits of an IPO without its insiders sacrificing control.

Since Google's IPO in 2004, dual class stock structures have grown in popularity, especially among technology companies. Other industry leaders like Facebook, Snap, Fitbit, and GoPro have used dual class structures to ensure founders and other insiders retain control over the management of the company.⁶ This trend of tech startups using dual class structures shows no signs of stopping.⁷ Indeed, the popularity of these structures has increased rapidly, especially in recent years.⁸

Despite its popularity among high-performing tech companies, academics, activists, and regulators have widely criticized dual class stock.⁹ These critics point to the separation of voting power and equity as inherently unfair to shareholders.¹⁰ This separation minimizes shareholder voice and creates agency costs and governance issues that cannot be addressed by traditional reforms or procedures. Additionally, critics argue the minimized voting rights destroy the legitimacy of corporations by minimizing or in some cases, removing, one of the most democratic pieces of corporate governance: voting rights.¹¹

The increased use of dual class stock structures is one part of a growing trend in public tech companies. Increasingly, founder-CEOs of tech companies dominate their business through outsized influence and voting

5. See *id.* (“[Page and Brin] acknowledged that the structure, which keeps voting power in the hands of the founders and original investors, would leave insiders with ‘significant’ control over the company’s decisions.”).

6. COUNCIL OF INSTITUTIONAL INV'RS, DUAL CLASS COMPANIES LIST 5, 6, 12 (2019), available at <https://www.cii.org/files/FINAL%20format%20Dual%20Class%20List%209-27-19.pdf> [<https://perma.cc/UY8R-B68L>].

7. Chris Dieterich, *Stock Indexes Push Back Against Dual-Class Listings*, WALL ST. J. (Aug. 2, 2017, 7:34 AM), <https://www.wsj.com/articles/stock-indexes-push-back-against-dual-class-listings-1501612170> [<https://perma.cc/TQ2S-SJUG>].

8. *Id.*

9. Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 599–601 (2017). See *infra* Section II.B for a more detailed discussion on dual class stock and its critics.

10. Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687, 713 (1986) (“Unless preferential treatment as to dividends and liquidation is provided with respect to the publicly offered securities or the differentiation is otherwise justified, the offering or proposed offering of equity securities of an issuer having more than one class of equity securities authorized or outstanding shall be considered unfair and inequitable to public investors if the class of equity securities offered to the public (a) has no voting rights or (b) has less than equal voting rights, in proportion to the number of shares of each class outstanding, on all matters, including the election of members to the board of directors of the issuer.” (quoting Statement of Policy on Non-Voting Stock, 1 NASAA Rep. (CCH) ¶ 2401)).

11. Robert J. Jackson Jr., *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, U.S. SEC. & EXCHANGE COMMISSION (Feb. 15, 2018), <https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty> [<https://perma.cc/4XFE-ASR7>] (discussing how “perpetual dual-class ownership” does not conform to American values, such as the “spirit of democratic accountability”).

power.¹² This dominance creates a host of corporate governance problems, most of which center on how a board of directors can effectively monitor a corporation where a CEO controls said directors' nomination, compensation, and retention.¹³ Additionally, lax definitions regarding director independence and the potential for unconscious bias further decreases the likelihood that the board, as currently constructed, is sufficiently powerful and motivated to ensure the company is acting in the best interests of *all* shareholders.¹⁴

The concerns regarding effective monitoring of a dominant CEO are not theoretical. Studies indicate that companies with a dominant CEO perform differently than companies with less powerful CEOs.¹⁵ The difference in performance is not always negative, indicating that a dominant CEO can have a positive impact in certain situations.¹⁶ As a result, reforms designed to empower the board of directors in the dominant CEO context should be aimed at reducing the negative performance implications, while leaving the potential positive externalities intact.

In this Note, I will recommend several potential reforms that can be advanced by the corporation itself, regulators, activists, and courts to better govern tech companies with dominant CEOs. Part II will specifically note the increase in dominant tech CEOs, the role of the independent board as a monitor of the corporation, and how independence is defined under current law. Part II will also note the inherent limitations associated with the independent board, specifically those conflicts that arise from social ties and unconscious bias, neither of which are disqualifying under current definitions of independence. Part III will discuss studies regarding corporate performance under a dominant CEO and how dominant tech CEOs may negatively impact firm performance, given the tech industry's turbulent environment.

Finally, Part IV will advance certain reforms that may decrease a dominant CEO's control over the board of directors and empower directors to take an active role in monitoring company management, which could mitigate the extreme and often negative performance associated with a dominant CEO. These reforms include a higher standard for director independence and allowing minority shareholders to appoint a certain

12. See Alan Patricof, *We Over Me: The Abuse of Power by Founder CEOs*, LINKEDIN (Sept. 17, 2019), <https://www.linkedin.com/pulse/we-over-me-abuse-power-founder-ceos-alan-patricof> [<https://perma.cc/gN55-BJDE>].

13. Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1274 (2017) ("Because these arrangements provide controllers with decisive power to appoint independent directors and decide whether to retain them, independent directors have significant incentives to side with the controller and insufficient countervailing incentives to protect public investors in conflicted decisions.").

14. Yaron Nili, *Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure*, 43 J. CORP. L. 35, 53 (2017) (describing the current independence regime as "too little, too late, and too soft" (emphasis omitted)).

15. See *infra* Section III.A.

16. See *infra* Section III.A.

number of directors without input from the dominant CEO. These reforms would give minority shareholders a voice in corporate decisions and ensure that the board of directors acts as a proper monitor for the corporation.

II. THE DOMINANT TECH CEO AND THE INDEPENDENT BOARD

To understand the precarious position boards and shareholders find themselves in when dealing with a dominant CEO, particularly in the technology sector, it is necessary to understand what makes a CEO dominant and how recent industry trends have made dominant CEOs more prevalent. Section II.A will identify and define what makes a CEO dominant, both in fact and in practice under Delaware law, and it will analyze how new developments in technology and the decreasing corporate lifespan prompted the increase in dominant CEOs, especially with technology entrepreneurs. Section II.B will analyze the dual class stock system, its history, and its use by founder-CEOs in the technology space. Section II.C will analyze the independent board of directors, its powers, and the inherent conflicts that arise when it attempts to fulfill its fiduciary duty.

A. WHAT IS A DOMINANT CEO UNDER DELAWARE LAW?

Under Delaware law, a stockholder is deemed controlling “when the stockholder: (1) owns more than 50% of the voting power of a corporation or (2) owns less than 50% of the voting power of the corporation but ‘exercises control over the business affairs of the corporation.’”¹⁷ Thus, a CEO will be deemed *per se* a controlling shareholder where the CEO owns more than 50 percent of the corporation’s voting power.¹⁸ Additionally, where a CEO owns less than 50 percent of the stock in the corporation, they nevertheless may also be considered controlling when their sway over the board is “so potent that independent directors . . . [could not] freely exercise their judgment.”¹⁹ This level of control can be shown as either a general matter or in regards to a particular challenged transaction.²⁰ To prove a stockholder dominates a corporation despite owning less than 50 percent of the shares, a plaintiff must plead “(1) that the minority blockholder actually dominated and controlled the corporation, its board or the deciding committee with respect to the challenged transaction or (2) that the minority blockholder actually dominated and controlled the majority of the board

17. *In re Tesla Motors, Inc. Stockholder Litig.*, No. 12711-VCS, 2018 WL 1560293, at *12 (Del. Ch. Mar. 28, 2018) (emphasis omitted) (quoting *Kahn v. Lynch Commc’ns Sys., Inc.*, 638 A.2d 1110, 1113–14 (Del. 1994)).

18. *Id.*

19. *In re Morton’s Rest. Grp., Inc. S’holders Litig.*, 74 A.3d 656, 665 (Del. Ch. 2013) (quoting *In re PNB Holding Co. S’holders Litig.*, No. Civ.A. 28-N, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006)) (noting the high bar required to prove a minority blockholder exercises actual control over the affairs of the corporation).

20. *See Carsanaro v. Bloodhound Techs., Inc.*, 65 A.3d 618, 659 (Del. Ch. 2013) (noting that “[t]he requisite degree of control can be shown to exist generally or ‘with regard to the particular transaction that is being challenged’” (quoting *Williamson v. Cox Commc’ns, Inc.*, No. Civ.A. 1663-N, 2006 WL 1586375, at *4 (Del. Ch. June 5, 2006))).

generally.”²¹ This inquiry is “intensely factual”²² and as such, generalizations about when a CEO without full voting control will be deemed controlling are difficult. Delaware courts have considered a wide variety of factors to determine whether a shareholder is controlling.²³

Among these factors, the most straightforward is the percentage of stock owned by the alleged controlling shareholder.²⁴ However, Delaware courts have not articulated what level of stock ownership under 50 percent is per se sufficient or insufficient to deem an individual a controlling shareholder.²⁵ Indeed, when just analyzing percentage of ownership as the only factor, Delaware courts appear rather inconsistent in deciding who is and is not a controlling shareholder.²⁶ In *In re Cysive, Inc. Shareholders Litigation*, the court found a stock ownership of 35 percent, along with other factors, sufficient to find the CEO a controlling shareholder.²⁷ This is the lowest percentage of stock ownership that has resulted in a finding of control by a shareholder beyond the pleading stage.²⁸ However, more recent cases indicate that lower ownership levels may be sufficient, if only to survive a motion to dismiss.²⁹

21. *In re Tesla Motors*, 2018 WL 1560293, at *13.

22. *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 550–51 (Del. Ch. 2003).

23. *See id.* at 535, 551–52 (noting the controlling shareholder’s 35 percent voting power in the corporation and how his position as CEO and Chairman likely increased his influence over the board); *see also* *Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, No. Civ.A. 1668-N, 2006 WL 2521426, at *4 (Del. Ch. Aug. 25, 2006) (“[T]he focus of the inquiry has been on the *de facto* power of a significant (but less than majority) shareholder, which, when coupled with other factors, gives that shareholder the ability to dominate the corporate decision-making process.”).

24. Percentage ownership is almost always the starting point for the controlling shareholder analysis. *See In re Tesla Motors*, 2018 WL 1560293, at *3 (beginning the analysis by stating the CEO’s percentage ownership); *In re Cysive*, 836 A.2d at 551 (noting as an initial matter that the CEO did not control an outright majority of voting shares); *see also In re PNB Holding*, 2006 WL 2403999, at *10 (noting as a first issue that the alleged controllers did not hold a majority of voting shares).

25. *In re PNB Holding*, 2006 WL 2403999, at *9 (“[T]here is no absolute percentage of voting power that is required in order for there to be a finding that a controlling stockholder exists.”).

26. *See In re Crimson Expl. Inc. Stockholder Litig.*, No. 8541–VCP, 2014 WL 5449419, at *12 (Del. Ch. Oct. 24, 2014) (deciding against finding a 33.7 percent ownership stake controlling because such a finding would be “aggressive”); *In re W. Nat’l Corp. S’holders Litig.*, No. 15927, 2000 WL 710192, at *6 (Del. Ch. May 22, 2000) (finding that approximately 46 percent control was not sufficient to deem defendant a controlling shareholder). *But see In re Zhongpin Inc. Stockholders Litig.*, C.A. No. 7393-VCN, 2014 WL 6735457, at *1, *12 (Del. Ch. Nov. 26, 2014), *abrogated on other grounds by In re Cornerstone Therapeutics Inc., Stockholder Litig.*, 115 A.3d 1173, 1179–80 (Del. 2015) (finding it reasonably conceivable that a 17.3 percent stockholder was a controller); *In re Alloy, Inc. S’holder Litig.*, No. 5626–VCP, 2011 WL 4863716, at *8 (Del. Ch. Oct. 13, 2011) (declining to rule out that a mere 15 percent stockholder could ever be considered a controller, but concluding that “collective stock ownership of 15% do[es] not, without specific allegations of domination, create an inference that [a stockholder] controlled the board”).

27. *In re Cysive*, 836 A.2d at 551–52.

28. *Id.*

29. *See In re Tesla Motors*, 2018 WL 1560293, at *14 (holding a 22.1 percent ownership stake could be deemed controlling, when considered with other factors); *In re Zhongpin*, 2014 WL 6735457, at *6–7; *In re Alloy*, 2011 WL 4863716, at *8–10.

Another factor in determining control is what role the shareholder plays within the corporation.³⁰ Specifically, when the major shareholder is also the CEO, courts have viewed that as tending to show control over the board of directors.³¹ This tendency is especially true where the CEO is also chairman of the board.³²

Finally, recent Delaware cases have considered the corporation's own statements when determining whether a controlling shareholder exists.³³ For example, the court in *In re Zhongpin Inc. Stockholders Litigation* noted that the corporation's public disclosures singled out a major shareholder as having significant influence over its management and affairs.³⁴ The disclosures went one step further, expressly describing the blockholder as "our controlling shareholder."³⁵ Similarly, the court in *In re Tesla Motors, Inc. Stockholder Litigation* noted that Tesla's public disclosures conceded that CEO Elon Musk exercised significant control and influence over the board of directors and the corporation as a whole.³⁶ The court also analyzed Musk's own statements, in which he declared Tesla "his company" and stated Tesla was one piece of "a 'pyramid' on top of which he sits."³⁷ While Tesla did not expressly call Musk a controlling shareholder, the court, unlike in *Zhongpin*, nonetheless found these public acknowledgements relevant in determining whether Musk did indeed exercise influence over the board to the point of controlling it.³⁸

Advances in technology, robust private equity, and mergers and acquisitions ("M&A") markets have decreased the average corporate lifespan.³⁹ As a direct result of this decrease, CEOs who founded the corporation and took it through an initial public offering have increased in number.⁴⁰ These founder-CEOs are more likely to retain huge stakes in their newly public companies than their successors.⁴¹ This stake, along with their

30. *In re Cysive*, 836 A.2d at 552 (noting shareholder was CEO and Chairman as a factor in favor of finding him a controlling shareholder).

31. *See id.* at 550–52.

32. *See id.*

33. *In re Tesla Motors*, 2018 WL 1560293, at *3–6; *In re Zhongpin*, 2014 WL 6735457, at *7.

34. *In re Zhongpin*, 2014 WL 6735457, at *7.

35. *Id.*

36. *In re Tesla Motors*, 2018 WL 1560293, at *18–19.

37. *Id.* at *19.

38. *Id.*

39. Michael Sheetz, *Technology Killing Off Corporate America: Average Life Span of Companies Under 20 Years*, CNBC, <https://www.cnbc.com/2017/08/24/technology-killing-off-corporations-average-lifespan-of-company-under-20-years.html> [<https://perma.cc/7DST-RBGZ>] (last updated Aug. 24, 2017, 2:12 PM) (noting the increased disruption effects of new technology companies and how the shortening of the corporate lifespan is likely to continue).

40. *See* Rolfe Winkler & Maureen Farrell, *In 'Founder Friendly' Era, Star Tech Entrepreneurs Grab Power, Huge Pay*, WALL ST. J., <https://www.wsj.com/articles/in-founder-friendly-era-star-tech-entrepreneurs-grab-power-huge-pay-1527539114> [<https://perma.cc/J7S3-4V67>] (last updated May 28, 2018, 11:18 PM).

41. A recent survey of 71 tech sector IPOs revealed that on average, founder CEOs retain 15 percent of the equity of the newly public corporation. *See* Ilya Levtoy, *How Much Equity Do Founders Have When Their Company IPOs?*, PRICEONOMICS (Dec. 8, 2016), <https://>

title and influence, can lead to dominance over the board of directors and the corporation's management.

Innovation and technology are allowing new companies to grow and gain market shares faster than ever before.⁴² This process, referred to as "creative destruction," results when something new brings about the destruction of something old.⁴³ This process is uniquely capitalistic and has existed throughout time.⁴⁴ However, the speed of creative destruction has rapidly increased over the past several decades, resulting in rapid turnover of market share from older companies to innovative new upstarts.⁴⁵ A clear example of creative destruction is in the realm of internet companies. Companies like MySpace, AOL, and Yahoo! dominated the internet less than 20 years ago.⁴⁶ These companies and many others like them are either gone or greatly diminished.⁴⁷ New technology built upon these past innovators and ended their reign.⁴⁸ Moreover, creative destruction is not limited to internet companies or technology. For example, the average age of a corporation in the S&P 500 in 1958 was 60 years.⁴⁹ Thus, many of these companies existed for decades and likely grew through several rounds of CEO succession. Today, the average age of a corporation in the S&P 500 is less than 20 years.⁵⁰

Why does this matter in the context of a dominant CEO? The dominant CEO is nothing new.⁵¹ Indeed, many of the mavericks who grew businesses in

priceonomics.com/how-much-equity-do-founders-have-when-their [https://perma.cc/DL3E-HJDN]. This includes 16 companies whose CEO retained more than 30 percent of the total equity of the company. *Id.*

42. See Laura Martin, *A Limited Life Span for Internet Companies*, N.Y. TIMES, <https://www.nytimes.com/roomfordebate/2011/11/02/can-yahoo-be-rescued/a-limited-life-span-for-internet-companies> [https://perma.cc/C29U-ZSHX] (last updated Nov. 3, 2011, 7:30 PM); Winkler & Farrell, *supra* note 40.

43. Joseph A. Schumpeter, CAPITALISM, SOCIALISM AND DEMOCRACY 82–85 (1942). Creative Destruction was first noted in the 1940s. *Id.* at 83 ("The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory to such concerns as U.S. Steel illustrate the same process of industrial mutation—if I may use that biological term—that incessantly revolutionizes the economic structure *from within*, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism.").

44. *Id.* at 83.

45. See Martin, *supra* note 42.

46. *Id.* ("MySpace, AOL and Yahoo were all dominant players in the Internet space, but [by 2011] they [were] troubled or gone.").

47. *Id.*

48. *Id.* ("Consumer-oriented Internet companies are brought to life through the application of a new technology and then unseated about 10 years later by a newer technology.").

49. See Sheetz, *supra* note 39; see also Kim Gittleson, *Can a Company Live Forever?*, BBC NEWS (Jan. 19, 2012), <https://www.bbc.com/news/business-16611040> [https://perma.cc/6JK3-CYFP] ("The average lifespan of a company listed in the S&P 500 index of leading US companies has decreased by more than 50 years in the last century, from 67 years in the 1920s to just 15 years today, according to Professor Richard Foster from Yale University.").

50. See Sheetz, *supra* note 39.

51. Henry Ford retained 55 percent of Ford until his death. Jim Henry, *Henry Ford Never Wanted his Company to go Public: Ford IPO was 'Biggest Stock Issue Ever'*, AUTOMOTIVE NEWS (June 16,

the early twentieth century held huge power within the corporation and used that power in ways in which minority shareholders may have disagreed.⁵² However, given the long life for S&P 500 companies at that time, such dominant CEOs were less common. After several rounds of succession, the CEO was unlikely to retain as much voting power as the original founder. As the timeframe of creative destruction has shrunk, the portion of founder-CEOs within the S&P 500 has increased. As a result, the issues related to dominant CEOs are more prevalent and will continue to be prevalent as the average corporate lifespan decreases.⁵³ This shift, along with the acceptance of dual classes of stock, has tremendously increased the importance of corporate governance methods designed to properly monitor the dominant tech CEO.

B. THE DUAL CLASS STOCK SYSTEM

Dual class stock systems are primarily used to allow a small portion of equity holders to retain voting control over a corporation.⁵⁴ Thus, a founder-CEO or other insiders can maintain voting control over the corporation while still reaping the benefits of outside equity.⁵⁵ This is typically done through Class A and Class B shares.⁵⁶ Class A is synonymous with common stock, a one share-one vote default offered to the public through an IPO.⁵⁷ However, granting voting power in publicly traded shares is not required.⁵⁸ Class B shares are not publicly traded and are typically retained by management.⁵⁹ These shares will typically hold multiple votes per share.⁶⁰ Thus, insiders at the company will be able to raise capital through external markets while retaining the benefits of corporate control.⁶¹ Section II.B.1 will analyze the history of the dual class system, academics' and government officials' criticism of the system, and regulators' and stock markets' responses to such criticism. Section II.B.2 will analyze the current trend towards dual class systems,

2003, 1:00 AM), <http://www.autonews.com/article/20030616/SUB/306160730/henry-ford-never-wanted-his-company-to-go-public> [<https://perma.cc/3KLZ-L3X4>].

52. Detailed information about founder-CEO ownership at this time is difficult to find, given the lax regulatory disclosure requirements.

53. See Winkler & Farrell, *supra* note 40.

54. Ben McClure, *The Two Sides of Dual-Class Shares*, INVESTOPEDIA, <https://www.investopedia.com/articles/fundamental/04/092204.asp> [<https://perma.cc/4M5Z-FZKZ>] (last updated June 25, 2019) ("Designed to give specific shareholders voting control, unequal voting shares are primarily created to satisfy owners who don't want to give up control, but do want the public equity market to provide financing.").

55. *Id.*

56. *Id.*

57. *Id.*

58. See *infra* Section II.B.2 for a discussion on Snap, Inc.'s recent IPO, which included a class of stock without any voting rights.

59. McClure, *supra* note 54.

60. *Id.*

61. See *id.*

specifically in the tech world where founder-CEOs are prevalent and have the power to retain functional control over the corporation, even after an IPO.

1. History of Dual Class Stock Structures⁶²

Similar to the concept of a dominant CEO, the dual class stock system is nothing new.⁶³ Media companies commonly used dual class structures, primarily to protect the integrity of news.⁶⁴ While most state incorporation statutes have a one share-one vote default rule, these statutes have not historically deemed dual class structures per se invalid.⁶⁵ In the 1980s, dual class structures were popular devices to entrench management against potential hostile takeover attempts.⁶⁶

The public has continuously and harshly criticized dual class stock structures.⁶⁷ As corporate financiers began to take advantage of more complex corporate structures, public outcry, fueled by academics and government officials, increased.⁶⁸ Specifically, the sale of the Dodge Brothers' debentures, preferred, and nonvoting common stock by Dillon, Reed & Company in 1925, which allowed Dillon Reed to retain voting control, stoked this criticism.⁶⁹ In response, the New York Stock Exchange ("NYSE") began disapproving of nonvoting common stock.⁷⁰

In 1940, the NYSE adopted a formal listing requirement for use of dual class stock.⁷¹ The NYSE also prohibited nonvoting common stock.⁷² This

62. For a more detailed discussion of the use of dual-class stock, its regulation, and its impacts, see generally Douglas C. Ashton, *Revisiting Dual-Class Stock*, 68 ST. JOHN'S L. REV. 863 (1994) (discussing the development of dual-class capital structures and recent criticism).

63. Outside of the traditional use by media companies and the recent boom in the technology sector, large IPOs of established companies have used dual class capital structures to retain control. Examples of this include Ford Motor Co., which split its private shares in 1935, giving Class B stock all of the voting power. See Henry, *supra* note 51. Still to this day, "the [Ford] family still controls about 40 percent of the shareholder vote." *Id.* Additionally, the IPO of Dodge Brothers in 1925 raised eyebrows because the owners retained voting control over the company despite only owning 1.7 percent of the equity. Benjamin Robertson & Andrea Tan, *Dual-Class Shares*, WASH. POST (Jan. 14, 2019, 8:25 PM), https://www.washingtonpost.com/business/dual-class-shares/2019/01/14/a6158f3a-186d-11e9-b8e6-567190c2fd08_story.html [<https://perma.cc/QC3P-CLRE>].

64. See David J. Berger & Laurie Simon Hodrick, *Are Dual-Class Companies Harmful to Stockholders? A Preliminary Review of the Evidence*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Apr. 15, 2018), <https://corpgov.law.harvard.edu/2018/04/15/are-dual-class-companies-harmful-to-stockholders-a-preliminary-review-of-the-evidence> [<https://perma.cc/JC97-UEVH>].

65. Ashton, *supra* note 62, at 904-05.

66. *Id.* at 895.

67. See Louis Lowenstein, *Shareholder Voting Rights: A Response to SEC Rule 19c-4 and to Professor Gilson*, 89 COLUM. L. REV. 979, 982 (1989).

68. Ashton, *supra* note 62, at 892.

69. *Id.* at 892-93.

70. *Id.*

71. See Seligman, *supra* note 10, at 699.

72. See Jackson Jr., *supra* note 11; see also Stephen Bainbridge, *Understanding Dual Class Stock Part I: An Historical Perspective*, PROFESSORBAINBRIDGE.COM (Sept. 9, 2017), <https://www>.

policy went mostly unchallenged until 1984⁷³ when General Motors issued a block of restricted shares.⁷⁴ Instead of threatening delisting of General Motors and a host of other companies that quickly followed with similar transactions, the NYSE relented and reevaluated its strict stance on dual class shares.⁷⁵

In 1987, the SEC attempted to regulate dual class systems through Rule 19c-4, which aimed to prevent stock exchanges from listing companies whose dual class transactions were designed to disenfranchise shareholders.⁷⁶ The Business Roundtable, a non-profit trade association made up of chief executive officers,⁷⁷ challenged this regulation, and the D.C. Circuit subsequently vacated it in 1990.⁷⁸ As a result, exchanges and states again retained regulatory control over dual class stock.⁷⁹ This system of state and exchange regulation has remained in place today. The default rule remains one share-one vote, with state blue sky laws imposing certain limitations “on the sale of . . . shares with disparate voting rights.”⁸⁰ Additionally, “[t]he New York Stock Exchange allows U.S. companies to list dual-class voting shares. Once shares are listed, however, companies cannot reduce the voting rights of the existing shares or issue a new class of superior voting shares.”⁸¹

Today, the debate continues about the proper way to regulate dual class voting structures. Proxy advisory services, institutional investors, and the SEC have all raised concerns about the governance problems and inherent unfairness that may exist by separating equity and voting rights across different classes of stock.⁸² Additionally, academics continue to criticize dual class structures. Lucian A. Bebchuk, a professor and the head of the Program on Corporate Governance at Harvard Law School, noted the risks and costs

professorbainbridge.com/professorbainbridgecom/2017/09/understanding-dual-class-stock-part-i-an-historical-perspective.html [https://perma.cc/AGG2-862B].

73. Ashton, *supra* note 62, at 894–95.

74. *Id.*

75. *Id.*

76. *Id.* at 898 (“Rule 19c-4 was designed to prohibit the NYSE, the AMEX, and NASDAQ from listing, or continuing to list, the securities of an issuer that takes action resulting in the nullification, restriction, or disparate reduction of the per-share voting rights of holders of the company’s outstanding common shares.”).

77. *About Us*, BUS. ROUNDTABLE, <https://www.businessroundtable.org/about-us> [https://perma.cc/P58P-FCA9].

78. *See* Bus. Roundtable v. SEC, 905 F.2d 406, 417 (D.C. Cir. 1990).

79. Ashton, *supra* note 62, at 900.

80. *Id.* at 904–05. For more on blue sky laws, see Troy Segal, *Blue Sky Laws*, INVESTOPEDIA (Apr. 1, 2019), <https://www.investopedia.com/terms/b/blueskylaws.asp> [https://perma.cc/3CZ3-j2H4].

81. McClure, *supra* note 54.

82. Berger & Hodrick, *supra* note 64 (“[T]he Council of Institutional Investors (‘CII’) has called upon the NYSE and Nasdaq to adopt a rule requiring all companies going public with dual-class shares to include a so-called ‘sunset provision’ in their charter, which would convert the company to a single class of stock after a set period of years. . . . Proxy advisory services have also announced their opposition to dual-class companies.”).

associated with companies that retain dual class stock structures well after an IPO.⁸³

In his analysis, Bebchuk concludes that dual class stock structures decrease in value as time passes and as such, should be either banned altogether or subject to a mandatory sunset after a certain time period.⁸⁴ Bebchuk also notes that controlling CEOs have strong incentives to retain the dual class structure, despite its inefficiency over time.⁸⁵ As a result of this pressure, several stock exchanges have enacted listing rules that prohibit or limit the use of dual class capital structures. For example, the S&P 500 stated in 2017 that they would no longer welcome new listings with dual class setups.⁸⁶

2. The Increased Use of Dual Class Shares by Technology Companies

As discussed above, small family businesses, media companies hoping to retain journalistic integrity, and other companies led by a strong group of insiders primarily used dual class capital structures.⁸⁷ Historically, it was not overly common for large IPOs to use the dual class structure. However, Google's 2004 IPO using dual class capital structure signaled a shift by technology companies to follow suit.⁸⁸ Currently, the co-founders of Google, Larry Page and Sergey Brin, retain 42.5 percent and 41.1 percent of Alphabet's class B voting shares, respectively.⁸⁹ This gives Page and Brin 51 percent voting power over Alphabet combined.⁹⁰ This trend grew stronger after 2010, with several large tech companies' IPOs using multiple classes of stock with different voting rights.⁹¹ As a result, many of these IPOs led to the founder-CEOs retaining voting control, or at least a significant voting share, of "their" companies. Between 2012 and 2016, 15 percent of tech companies

83. Bebchuk & Kastiel, *supra* note 9, at 630.

84. *Id.* ("Our analysis has demonstrated that, over time, the potential benefits of dual-class structures can be expected to decline and the potential costs to increase.").

85. *Id.* at 602 ("Entrenchment insulates controllers from the disciplinary force of the market for corporate control that otherwise might limit the ability of a poorly performing controller to continue leading the company. At the same time, controllers with low equity holdings bear only a small fraction of the negative effects of their actions on the company value while capturing the full private benefits. Thus, controllers' incentives regarding certain issues may become distorted and misaligned with the preferences of public investors.").

86. Nicole Bullock, *Investors Hail S&P 500 Move Over Multiple Class Shares*, FIN. TIMES (Aug. 1, 2017), <https://www.ft.com/content/0a441900-76ca-11e7-a3e8-60495fe6ca71> [<https://perma.cc/ALN4-Y94S>] ("S&P Dow Jones Indices said that after a committee review and feedback from market participants the so-called S&P Composite 1500, which is comprised of the S&P 500, S&P MidCap 400 and S&P SmallCap 600, would not include companies with multi-class share structures, but that existing constituents, such as Google, Berkshire Hathaway and Facebook, would be able to remain.").

87. Berger & Hodrick, *supra* note 64.

88. Bebchuk & Kastiel, *supra* note 9, at 594-95.

89. ALPHABET INC., NOTICE OF 2018 ANNUAL MEETING OF STOCKHOLDERS AND PROXY STATEMENT 30 (Apr. 27, 2018).

90. *See id.* at 58.

91. Dieterich, *supra* note 7.

that went public used at least two classes of stock, up from eight percent between 2007 and 2011.⁹² In an extreme example, Snap, Inc.'s IPO in 2017 included no voting rights at all, allowing the co-founders to retain a vast majority of the voting power.⁹³ Stock indexes, shareholder rights groups, and the SEC widely criticized Snap, Inc.'s decision.⁹⁴

Many of these tech IPOs have resulted in CEOs retaining huge voting rights that would potentially receive controlling shareholder treatment under Delaware law. Start-up tech entrepreneurs, anxious to preserve control against venture capitalists and institutional investors, have utilized the dual class capital structure more aggressively than any previous group of CEOs.

C. THE INDEPENDENT BOARD AND ITS LIMITATIONS

The separation of ownership and control inherent in all corporations results in agency costs.⁹⁵ These costs must be managed by proper monitoring and incentives to ensure those in control of the corporation (management) act in the best interest of the owners (shareholders).⁹⁶ Shareholders elect the

92. *Id.*; see also Bebchuk & Kastiel, *supra* note 9, at 594–95 (“Indeed, according to data-provider Dealogic, ‘[m]ore than 13.5 percent of the 133 companies listing shares on United States exchanges in 2015 have set up a dual-class structure . . . compare[d] with . . . just 1 percent in 2005.’” (quoting Steven Davidoff Solomon, *Shareholders Vote With Their Dollars to Have Less of a Say*, N.Y. TIMES: DEALBOOK (Nov. 4, 2015), <https://www.nytimes.com/2015/11/05/business/dealbook/shareholders-vote-with-their-dollars-to-have-less-of-a-say.html> [<https://perma.cc/674X-ZRQY>])).

93. Maureen Farrell, *In Snap IPO, New Investors to Get Zero Votes, While Founders Keep Control*, WALL ST. J. (Jan. 16, 2017, 8:24 PM), <https://www.wsj.com/articles/in-snap-ipo-new-investors-to-get-zero-votes-while-founders-keep-control-1484568034> [<https://perma.cc/YgZN-gUW8>] (“That leaves key decisions, such as the makeup of the board, primarily to Evan Spiegel and Bobby Murphy, co-founders of Snap, the owner of the disappearing-message app Snapchat. The two are expected to hold more than 70% of the voting power despite owning roughly 45% of the stock, the people said.”).

94. James Rufus Koren & Paresh Dave, *Snap Won't Give Shareholders Voting Rights. For that, It's Being Shunned by a Major Stock Index*, L.A. TIMES (July 28, 2017, 10:40 AM), <http://www.latimes.com/business/la-fi-snap-russell-indices-20170727-story.html> [<https://perma.cc/J8KZ-RX9M>] (“The move concentrated voting power among the firm’s founders and drew the ire of some institutional investors, who said the company’s structure would make it unaccountable to shareholders. Investors were concerned that, despite their objections to Snap’s structure, they would be forced to buy the company’s shares if Snap were included in major stock indices.”); see Ken Bertsch, *Snap and the Rise of No-Vote Common Shares*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 26, 2017), <https://corpgov.law.harvard.edu/2017/05/26/snap-and-the-rise-of-no-vote-common-shares> [<https://perma.cc/Q6TE-RUJJ>].

95. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 309 (1976) (“Since the relationship between the stockholders and manager of a corporation fit the definition of a pure agency relationship it should be no surprise to discover that the issues associated with the ‘separation of ownership and control’ in the modern diffuse ownership corporation are intimately associated with the general problem of agency.”).

96. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1539 (2007) (“There certainly was a substantive case for enhancing the independence-in-fact of directors, particularly if the managerial agency problem was to be addressed through incentive-based compensation and termination contracts rather than through control markers.”).

board of directors, and in turn, the board of directors monitor and have a fiduciary duty to the corporation.⁹⁷ Up to and including the 1950s, the board of directors primarily consisted of “insider” directors—the firm’s senior managers, some outsiders with financial interest in the working of the company (i.e., the corporation’s banker or outside lawyer), and potentially an occasional independent director (selected by the CEO).⁹⁸ During this time period, the attractiveness of an insider director focused on the advisory role often required of boards.⁹⁹ By having directors with deep connections and expertise regarding company-specific issues, the board would be in a better position to advise management about the best course of action.¹⁰⁰

The balance between insider and independent directors has shifted immensely over the past several decades.¹⁰¹ This change is a result of shifts in the board’s role from advising to monitoring, perceived market failures, and changes in regulatory and stock exchange rules.¹⁰² An independent or outside director is someone without a pecuniary or material interest in the corporation or related persons.¹⁰³ When a majority of directors on the board are independent, the board as a whole is said to be an independent board.¹⁰⁴ Section II.C.1 will analyze how board makeup has changed over the past 70 plus years. Section II.C.2 will discuss how methods of determining director independence have changed under Delaware law and regulatory definitions. Section II.C.3 will demonstrate how independent directors may still be biased in favor of CEO decisions, especially when a CEO retains dominant voting power or otherwise effectively controls the board.

1. The Rise of the Independent Director

As a result of several waves of change between the 1950s and today, the concept of an inside director has dwindled vastly. The concept of a monitoring board instead of an advising board, paired with the hostile bid era

97. *Id.* at 1468 (“The now-conventional understanding of boards of directors in the diffusely held firm is that they reduce the agency costs associated with the separation of ownership and control.”).

98. *See id.* at 1473–75.

99. *Id.* at 1511 (“For a 1950s firm, in addition to the profit-making objective, there were two other important elements: first, the impetus to balance among competing stakeholder objectives; second, the role of corporate management as a central planner. Both of these important elements arguably led to an ‘advisory’ board, in which the CEO’s trust in the board was critical, rather than a ‘monitoring’ board, in which the board’s trust in the CEO was the question.”).

100. *See* Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 179 (2010) (“Inside directors’ decisions are more likely to be informed because of their informational advantage over independent directors.”).

101. Gordon, *supra* note 96, at 1475.

102. *Id.* at 1477.

103. *See* James Chen, *Independent Outside Director*, INVESTOPEDIA (July 4, 2019), <https://www.investopedia.com/terms/i/independent-outside-director.asp> [<https://perma.cc/VRQ4-AY73>].

104. *See* Troy Segal, *Evaluating the Board of Directors*, INVESTOPEDIA, <https://www.investopedia.com/articles/analyst/03/111903.asp> [<https://perma.cc/X3NY-MPV8>] (last updated Mar. 27, 2020).

of the 1980s and the well-documented board failures of the early 2000s, led companies to drastically change the makeup of their boards.¹⁰⁵ Additionally, regulatory bodies and stock exchanges began requiring a majority of independent directors on boards and that certain committees be made up wholly or in part of independent directors.¹⁰⁶ In 1950, approximately 20 percent of directors were deemed independent; and by 2005, this number increased to approximately 75.¹⁰⁷

The first shift toward the independent director occurred in the 1970s as a result of wide corporate governance reform.¹⁰⁸ This reform adjusted the board of directors' role and purpose towards monitoring and away from advising.¹⁰⁹ Experts believed, and still do, that outsiders without conflicts of interest are better suited to monitor the corporation and ensure that management fulfills its fiduciary duty to shareholders.¹¹⁰ Second, the 1990s, on the heels of the hostile takeover boom, prompted a further increase of independent directors.¹¹¹ The takeover push and the rise in shareholder wealth maximization as the corporation's primary purpose increased the vital need for independent directors to act as monitors.¹¹² To effectively ensure shareholder value served as management's primary driver, institutional investors sought independent directors who, free of bias or fear of retaliation, could stand up to insiders.¹¹³ Finally, the large corporate governance and board oversight failures of the early 2000s solidified the need for independent directors who would ensure that management was playing by the rules.¹¹⁴

Today, in addition to the desire for broader independence in the boardroom, regulators and stock exchanges enforce their own independence requirements. The Sarbanes–Oxley Act (“Sarbanes–Oxley”) requires publicly traded companies to create an audit committee and that all members of that

105. See generally Gordon, *supra* note 96 (noting the rapid change in board makeup and explaining potential reasons).

106. Fairfax, *supra* note 100, at 133 (“Despite its prominence in corporate and securities law, the term ‘independent director’ has no uniform definition; instead judges and legislators define the term differently. Moreover, the term is used differently in various contexts.”).

107. Gordon, *supra* note 96, at 1475.

108. *Id.* at 1477.

109. *Id.* at 1469.

110. Fairfax, *supra* note 100, at 138–39 (“Importantly, it is believed that in order for directors to perform this monitoring function effectively, directors must be independent from management and the corporation.”).

111. Gordon, *supra* note 96, at 1521–22 (“In this environment, managers turned to the monitoring board and to independent directors as the best available protection against the hostile takeover movement, despite the encroachment on managerial autonomy.”).

112. *Id.* at 1520–23.

113. *Id.* at 1522–23 (“First, business elites needed a credible board-centered governance mechanism to address performance issues in substitution for the market-centered approach associated with the hostile tender offer.”).

114. See *id.* at 1535–36 (“The collapse of Enron, WorldCom, and similar but less catastrophic disclosure failures vividly demonstrated weaknesses in the board governance system produced by the 1990s and pointed the way towards new roles for independent directors and standards of independence.”).

committee be independent under its definition.¹¹⁵ Sarbanes–Oxley also requires that each national exchange adopt compatible rules.¹¹⁶ Additionally, the NYSE and NASDAQ require companies listed on their exchanges to have a board where a majority of directors are independent.¹¹⁷ These rules reflect the majority view that independent directors are far better suited to fulfill the board’s monitoring role than insiders or those with a substantial economic interest in the company.

2. How is Independence Defined?

A natural follow up to the discussion regarding the increase in independent directors is: what makes a director “independent” under the various laws and rules discussed above? This question varies significantly based on (1) the time period and (2) which judicial, regulatory, or non-governmental body is supervising the question. A brief discussion of the history of independence and its current state is beneficial to understand how implicit bias, social ties, and groupthink may still impact board decisions, despite this required definitional independence.

Today’s definitions for independence are even more precise. Sarbanes–Oxley states that an independent director on the audit committee must “not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee—(i) accept any consulting, advisory, or other compensatory fee from the issuer; or (ii) be an affiliated person of the issuer or any subsidiary thereof.”¹¹⁸ This focus is tied solely to financial relationships. Nothing in the requirement indicates a need to be socially separate from the management or the corporation.¹¹⁹

The NYSE Listed Company Manual states, in summary:

A director is not independent if she (or a member of her immediate family) either currently or in the preceding three years (a) is an employee, (b) has received \$120,000 or more from the company in a twelve-month period, (c) is associated with the company’s internal or external auditor, (d) is an executive officer of another company that had officers of the first company on its compensation committee, or (e) is an executive officer of a company that has had

115. 15 U.S.C. § 78j-1(m)(3) (2012).

116. *Id.* § 78j-1(m)(1)(A).

117. NYSE, LISTED COMPANY MANUAL § 303A.01 (2009), available at https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D-WKUS_TAL_5667%23eid-69 [<https://perma.cc/NNH4-5RFT>] (“Listed companies must have a majority of independent directors.”); NASDAQ, MARKETPLACE RULES § 5605(b)(1) (2006), available at <http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.aspx?searched=1&selectednode=chp%5F1%5F1%5F4%5F4%5F8%5F3&CiRestriction=5605&manual=%2FNASDAQ%2FMain%2Fnasdaq%2Dequityrules%2F> [<https://perma.cc/L2U5-KF4P>] (“A majority of the board of directors must be comprised of Independent Directors as defined in Rule 5605(a)(2).”).

118. 15 U.S.C. § 78j-1(m)(3)(A).

119. *Id.* § 78j-1(m)(3).

transactions exceeding \$1 million or 2 percent of its gross revenue with the director's company.¹²⁰

Similar to Sarbanes–Oxley, these requirements focus almost entirely on financial or business relationships.

Unlike the bright-line rules in these regulations, Delaware courts approach the issue of director independence on a case-by-case basis. This is likely a result of lawsuits dealing with specific transactions, where director independence will be questioned on specific facts. Delaware law presumes directors as independent unless shown otherwise.¹²¹ Delaware divides the inquiry into two parts: (1) “whether the director is disinterested in the underlying transaction and,” (2) “even if disinterested, whether the director is otherwise independent.”¹²² Disinterested refers to the personal financial benefits that will flow to the director, and not shareholders. “[O]therwise independent” refers to the director's state of mind, which a plaintiff can show by specific evidence that the director at issue is “‘beholden’ to an interested director.”¹²³ Traditionally, this standard does not include most social ties or close friendships. For example, the court in *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart* held the friendship between two directors and Martha Stewart, who was the subject of the lawsuit, did not create reasonable doubt about the directors' independence.¹²⁴ The court stated that the friendship “must be of a bias-producing nature. . . . ‘Not all friendships, or even most of them, rise to this level.’”¹²⁵ The court held that even though Stewart appointed the directors and could remove them at any time, she did not dominate them.¹²⁶

While the law itself has not shifted, more recent Delaware cases indicate that, as the court noted in *Beam*, some personal relationships can rise to the level of bias producing.¹²⁷ *Sandys v. Pincus*¹²⁸ is the best example of this recent trend. In *Pincus*, the court held director Ellen Siminoff was not independent as a result of her close personal and business relationship with company CEO Mark Pincus.¹²⁹ The court focused specifically on Siminoff and Pincus' co-ownership of a private jet.¹³⁰ The court stated:

120. Antony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 237, 241 (citing NYSE, INC., LISTED COMPANY MANUAL § 303.02(b)(i)–(v) (2004)).

121. *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1049 (Del. 2004) (“Independence is a fact-specific determination made in the context of a particular case.”).

122. *Id.*

123. *Id.* at 1049–50.

124. *Id.* at 1056.

125. *Id.* at 1050 (quoting *Beam*, 833 A.2d at 979).

126. *Id.* at 1056–57.

127. *Id.* at 1052 (“That is not to say that personal friendship is always irrelevant to the independence calculus.”).

128. *Sandys v. Pincus*, 152 A.3d 124, 126–27 (Del. 2016).

129. *Id.* at 126–27.

130. *Id.* at 126 (“First, the plaintiff pled a powerful and unusual fact about one director's relationship to Zynga's former CEO and controlling stockholder which creates a reasonable

[O]wning an airplane together is not a common thing, and suggests that the Pincus and Siminoff families are extremely close to each other and are among each other's most important and intimate friends. Co-ownership of a private plane involves a partnership in a personal asset that is not only very expensive, but that also requires close cooperation in use, which is suggestive of detailed planning indicative of a continuing, close personal friendship. In fact, it is suggestive of the type of very close personal relationship that, like family ties, one would expect to heavily influence a human's ability to exercise impartial judgment.¹³¹

Thus, while the general Delaware rule is that social ties do not affect independence, the *Pincus* holding opens the door for courts to consider close personal relationships as bias producing.

3. The Remaining Potential Conflicts

"No definition of independence yet offered precludes an independent director from being a social friend of, or a member of the same clubs, associations, or charitable efforts as, the persons whose compensation or self-dealing transaction he is asked to assess."¹³² Despite the progressively constricted definitions of independence under regulatory, judicial, and non-governmental bodies, questions still remain about whether these definitions are sufficient to ensure the board of directors is fulfilling its role as an impartial monitor of the corporation. These issues are especially relevant where a dominant CEO has control over each director's position on the board. This Section analyzes potential bias-raising issues for board members that do not rise to the level of disqualification under current independence definitions.

First, self-interest may push directors to act in ways that do not advance the best interest of shareholders. This can be true in multiple contexts. Most obviously, the directors' desires to remain on the board can be a powerful motivator towards rejecting hostile takeovers or avoiding conflicts with a dominant CEO.¹³³ Board members are compensated well for their time,¹³⁴

doubt that she can impartially consider a demand adverse to his interests. That fact is that the controlling stockholder and the director and her husband co-own an unusual asset, an airplane, which is suggestive of an extremely intimate personal friendship between their families.").

131. *Id.* at 130.

132. Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 613 (1982).

133. Page, *supra* note 120, at 255.

134. The median director compensation is over \$250,000. Gregory H. Shill, *The Golden Leash and the Fiduciary Duty of Loyalty*, 64 UCLA L. REV. 1246, 1267 (2017) ("An independent directorship at a large company is a prestigious role asking five hours of work per week for \$255,000 in median annual salary." (citing Theo Francis & Joann S. Lublin, *Corporate Directors' Pay Ratchets Higher as Risks Grow*, WALL ST. J. (Feb. 24, 2016, 3:29 PM), <http://www.wsj.com/articles/corporate-directors-pay-ratchets-higher-as-risks-grow-1456279452> [<https://perma.cc/ER26-MELC>])).

and the position offers a high level of prestige.¹³⁵ Additionally, serving on one board can often lead to the opportunity to sit on other boards.¹³⁶ With all of the benefits that come with sitting on a board, a director may value their own position higher than their duty to shareholders. This is true regardless of potential social ties with company management or other directors. A dominant CEO is in a position to maximize director self-interest because the dominant CEO controls who is hired or fired and can often be a powerful voice for increasing director benefits.¹³⁷ For example, a dominant CEO is in an excellent position to increase director compensation, if desired.¹³⁸ The CEO's control over the directors' positions and purse, which does not legally impact director independence, can play a powerful role in how directors view decisions.

Second, in-group bias may lead directors to unconsciously view decisions as correct because they favor the members of their own group.¹³⁹ Generally, this bias will occur when an individual identifies themselves as part of a group and believes the members of that group are achieving at a higher level than those outside of the group.¹⁴⁰ In-group biases can create problems within boards, which meet regularly and often retain similar composition over several years.¹⁴¹ Thus, board members may be favorably biased towards other members of their group because they feel they are achieving at a high level. Even directors who are defined as independent can be swayed by in-group bias.¹⁴² Additionally, the directors may favorably perceive the CEO, who is often a member of the board and chairman of the board.¹⁴³ As a result, in-

135. *Id.* at 1267–68 (“A director’s service is primarily motivated by other factors, such as prestige and enhancing their profile for other assignments.”).

136. Page, *supra* note 120, at 256 (“Foreclosing a derivative suit or acquiescing in executive salary raises is unlikely to raise any eyebrows among top executives or other board members. Furthermore, a reputation for loyalty may in fact increase a director’s desirability to CEOs or others involved in the selection of board members.”).

137. Fairfax, *supra* note 100, at 158 (“In fact, studies reveal that CEOs often dominate the director-nomination process, causing directors to feel beholden to CEOs. Thus, the director-selection process does little to incentivize effective monitoring and instead increases the potential for managerial and CEO capture.” (footnote omitted)). Where a CEO controls a majority or substantial amount of the voting power of the corporation, this control goes beyond simply the nomination process and can mean actual control over who is on the board.

138. Page, *supra* note 120, at 254 (noting that “a CEO can ‘use his or her bully pulpit to support higher director compensation’” (quoting Lucian A. Bebchuk & Jesse M. Fried, *Pay Without Performance: Overview of the Issues*, 30 J. CORP. L. 647, 656 (2005))).

139. *Id.* at 249 (“Though the notion of ingroup bias may be unsurprising when applied to groups based on race or ethnicity, nationality, religious belief, or even college alma mater, ingroup bias occurs even when the groups are categorized on a trivial or random basis, like a coin toss, sharing the same fingerprint type, birthday, or final digit of a social security number.”).

140. *Id.*

141. *Id.* at 252–53.

142. *Id.* at 252 (“Directors, even those defined as independent, are members of the board of directors and, so the theory goes, are likely to be biased in favor of other directors.”).

143. *Id.* at 259 (“For example, should we approve the CEO compensation package? (Yes, because he is like us, a member of my group, and thus he deserves it; and for directors who are also CEOs, yes, because it may favorably affect my own compensation.)”).

group bias may reduce the monitoring role's effectiveness, especially where directors are asked to evaluate other members whom they perceive as part of their group.

Finally, one of the key defenses raised in support of limiting definitions of independence—risk to director reputation—may be ineffective because reputation for lax monitoring may actually be attractive to CEOs or others looking to fill director positions.¹⁴⁴ Delaware courts have required plaintiffs to show that “the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director.”¹⁴⁵ This line of reasoning requires that a director's reputational harm results from an inaction or failure to properly monitor the corporation.¹⁴⁶

This argument also requires that the director's reputation is harmed not only in the general community, but also among the director's peer group or social circle.¹⁴⁷ The inverse of this reputational assumption seems more plausible. In reality, lax monitoring may be viewed positively to a dominant CEO who desires to retain control over company decision-making.¹⁴⁸ A director who consistently questions management and voices displeasure with policies is unlikely to last long-term or receive a strong recommendation to other, similarly situated companies.¹⁴⁹

III. EMPIRICAL EVIDENCE OF CORPORATE GOVERNANCE DIFFERENCES WITH DOMINANT CEOs

Simply pointing out the structural and governance issues that may exist with a dominant CEO is illustrative, but it does not directly implicate a problem that requires changing a corporation's governance systems with a dominant CEO. If there was no evidence that CEO-dominated firms performed differently than peer firms or the market as a whole, one could conclude that either: (1) governance generally has little or no effect on firm performance, or (2) dominant CEOs do not impact governance or firm

144. Fairfax, *supra* note 100, at 149 (“[I]t is not clear that directors' business and professional reputations suffer as a result of 'favoring' the social relationships they have with managers and board members. Indeed, anecdotal and empirical evidence indicates that directors may not experience significant harm when they make decisions based on such social relationships. At least some studies reveal that directors continue to hold board seats and be accepted within the business community even after evidence that they may have acquiesced in large frauds.”).

145. Beam *ex rel.* Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1052 (Del. 2004).

146. *Id.* at 1047 (“Although the amended complaint lists fewer positions of fiduciary responsibility for Moore than were listed for Martinez, it is clear that *Moore's professional reputation similarly would be harmed* if she failed to fulfill her fiduciary obligations.” (emphasis added)).

147. Which, as discussed, is not a safe assumption given available data. See *supra* note 140 and accompanying text.

148. Page, *supra* note 120, at 256 (“Furthermore, a reputation for loyalty may in fact increase a director's desirability to CEOs or others involved in the selection of board members.” (footnote omitted)).

149. Fairfax, *supra* note 100, at 149 (“Thus, directors have strong incentives to behave in ways that ensure their continued presence on the board, and such behavior often includes compliance with norms against questioning managerial policies.” (footnote omitted)).

performance relative to peer firms in any significant way. This Part will determine whether the increase in dominant tech CEOs requires increased judicial or regulatory scrutiny or governance changes by analyzing how firms with dominant CEOs perform. Section III.A will discuss the numerous studies that have attempted to link dominant CEOs and firm performance. Section III.B will consider what conclusions can be drawn from this and if changes in governance can be justified from an empirical perspective. Section III.C will note that the existence of a dominant CEO, by its very nature, eliminates several powerful governance tools that could otherwise be used to assist shareholders and the board of directors in effectively ensuring that management is acting in the best interest of the company and its long term value. As a whole, this Part will argue that dominant CEOs present a relevant and challenging problem for company boards, regulators, and courts.

A. STUDIES OF CEO POWER

The studies linking CEO dominance and firm performance are inconsistent in at least one key area: how CEO dominance is determined. Some studies analyze CEO duality (where a CEO is also the chairman of the board).¹⁵⁰ Others design an “index of power,” using various factors to determine whether “power is unevenly concentrated in a firm’s CEO.”¹⁵¹ Another study measured the impact an unexpected CEO death had on stock price to determine how much power the market believed the CEO had on firm value.¹⁵²

A 1993 study by Jerayr Haleblian and Sydney Finkelstein determined firms with more powerful CEOs performed poorly in “turbulent (high velocity) environment[s].”¹⁵³ They hypothesized that CEO power has different effects depending on the company’s industry.¹⁵⁴ When comparing firm performance across two industries, computers (more turbulent)¹⁵⁵ and

150. Brian K. Boyd, *CEO Duality and Firm Performance: A Contingency Model*, 16 STRATEGIC MGMT. J. 301, 301 (1995) (“CEO duality exists when a firm’s chief executive also serves as Chairman of the board of directors.”).

151. Jerayr Haleblian & Sydney Finkelstein, *Top Management Team Size, CEO Dominance, and Firm Performance: The Moderating Roles of Environmental Turbulence and Discretion*, 36 ACAD. MGMT. J. 844, 851–52 (1993) (“To assess CEO dominance for the large study group used here, we relied on ten objective measures of power that were thought to cumulatively explain overall power.”).

152. James G. Combs et al., *The Moderating Effect of CEO Power on the Board Composition–Firm Performance Relationship*, 44 J. MGMT. STUD. 1299, 1300 (2007) (“We examine the potential moderating role of CEO power using data from 73 US firms that experienced unexpected CEO deaths. Following an unexpected death, stock prices should adjust to reflect shareholders’ perception of the firm’s value without the deceased. Management cannot manipulate the timing of unexpected deaths. Thus, they provide a rare, unspoiled glimpse into how certain variables, such as board composition and CEO power, shape firm value.”).

153. Haleblian & Finkelstein, *supra* note 151, at 859.

154. *See id.* at 849 (“Hypothesis 2: CEO dominance will be more negatively associated with firm performance in a turbulent environment than in a stable environment.” (emphasis omitted)).

155. *Id.* (explaining “we chose the computer industry, which is characterized by continuous product innovation, high growth rates, and high product differentiation, as the turbulent, high-discretion environment”).

natural gas distribution (more stable),¹⁵⁶ Haleblian and Finkelstein found that greater CEO power in the computer industry resulted in more negative firm performance.¹⁵⁷ Thus, the authors concluded that greater CEO power has a negative impact on firm performance in turbulent industries.¹⁵⁸ Another study by John R. Graham et al. explored the relationship between CEO power and stock prices by analyzing how stock prices changed after the death of a powerful CEO.¹⁵⁹

Their study supports the hypothesis that powerful CEOs extract excess pay and become entrenched, which results in a decrease in shareholder value.¹⁶⁰ Specifically, the study noted that “CEO turnover is associated with 2.7% to 3.1% higher announcement returns when the departing CEO was more powerful In contrast, departures of CEOs who had relatively little power before leaving office entail insignificant announcement returns ranging from -1.3% to 0.6%.”¹⁶¹

Another recent study concluded that dominant CEOs are more likely to produce extreme results for their companies when compared to less powerful CEOs.¹⁶² Using a sample of 51 publicly traded companies in the U.S. computer industry, Tang et al. found that dominant CEO-led firms often have a “deviant strategy.”¹⁶³ Thus, dominant CEOs are associated with either great failure or great success.¹⁶⁴ The study also indicated that powerful boards are capable of minimizing the risk of great failure.¹⁶⁵ The study concluded by noting that a dominant CEO, paired with a powerful board, may “represent[] an ideal governance arrangement.”¹⁶⁶ However, as will be noted in more detail

156. *Id.* (noting that the authors “chose the natural gas distribution industry, which is governed by regulations controlling pricing and capital acquisition, as the stable, low-discretion environment”).

157. *Id.* at 855 (“Hypothesis 2 predicts that CEO dominance will be more negatively associated with firm performance in the computer industry than in the natural gas industry. To test this hypothesis, we added the interaction of CEO dominance and the computer industry dummy to the base model. As model 3 indicates, the coefficient for this interaction term was negative and significant, supporting Hypothesis 2.”).

158. *Id.* at 859 (“Our findings are consistent with those of Eisenhardt and Bourgeois (1988), who found that top teams with dominant CEOs, which they referred to as ‘centralized,’ contributed to poor performance in a turbulent (high-velocity) environment.”).

159. See John R. Graham et al., *CEO-Board Dynamics* 35 (June 12, 2019) (unpublished manuscript), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2938120 [<https://perma.cc/HUN6-RHS4>].

160. *Id.* at 37 (“These findings are consistent with the argument that powerful CEOs can become entrenched or extract excess pay, and thus removing these CEOs (which presumably would have been costly without a death occurrence) would increase shareholder value.”).

161. *Id.* at 36.

162. Jianyun Tang et al., *Dominant CEO, Deviant Strategy, and Extreme Performance: The Moderating Role of a Powerful Board*, 48 J. MGMT. STUD. 1479, 1497 (2011).

163. *Id.*

164. *Id.* at 1500.

165. *Id.* at 1498–99 (“As noted, our results suggest that dominant CEOs tend to bring to their firms extreme performance—either big wins or big losses, and powerful boards improve the likelihood of dominant CEOs having big wins versus big losses.”).

166. *Id.* at 1498.

below, maintaining a powerful board in the presence of a dominant CEO can be difficult.

Finally, studies on dual class stock structures, as discussed above,¹⁶⁷ indicate that controlling shareholders with voting power greater than their equity interests have “perverse incentives” not to sell, even when a sale would maximize value for other shareholders.¹⁶⁸ Granting this control to a dominant CEO is a cost to all other shareholders that reduces firm value in certain situations.¹⁶⁹ A dominant CEO with such control could consider private benefits when deciding whether to sell.¹⁷⁰ Thus, the CEO could reject a price that is below the value of his private benefits, but would otherwise maximize shareholder value.¹⁷¹ Assuming the CEO and the company used appropriate transaction procedures considered under the business judgment rule, a court would likely uphold the CEO’s rejection.

Overall, the studies relating CEO dominance to firm performance return mixed results. Importantly, almost every study examining CEO power found a statistically significant difference in firm performance based on the CEO’s power. As discussed in Section III.B, this difference is significant from a corporate governance perspective.

B. IMPACTS OF CEO POWER AND FIRM PERFORMANCE

These studies illuminate a telling byproduct of dominant CEOs: Firm performance differs in statistically significant ways when a CEO dominates both the board of directors and the company at large. While the effects on firm performance are not categorically negative, the existence of potential negative performance in certain circumstances, namely in turbulent industries and sales price, signals an agency cost problem. These negative performance metrics present an opportunity for greater oversight, whether by the company, stock exchanges, or regulators. At a minimum, such oversight would reduce the negative performances associated with dominant CEOs. Ideally, any action taken would not remove the potential positives associated with firm performance, but would reduce the agency problems and monitoring issues associated with CEO dominance.

The study by Halebian and Finkelstein is especially salient in the dominant tech CEO context.¹⁷² The technology industry is notoriously turbulent, given the speed of creative destruction. Thus, this industry appears to be one of the worst industries for there to be a large amount of dominant

167. See *supra* Section II.B.1; see also Bebchuk & Kastiel, *supra* note 9, at 614.

168. Bebchuk & Kastiel, *supra* note 9, at 613 (“Whereas the sale would eliminate the controller’s private benefits of control, the controller would capture only a minority (or even a small minority) of the produced efficiency gains, which would be shared pro rata by all shareholders.”).

169. See *id.* at 614 (“Thus, there is a wide range of situations in which a sale that would produce gains from eliminating an inefficient dual-class structure would not take place.”).

170. See *id.* at 614–15.

171. See *id.*

172. See Halebian & Finkelstein, *supra* note 151, at 859.

CEOs. However, as discussed above, tech companies are increasingly using dual class stock structures and allowing founders to retain huge equity and voting power post-IPO.¹⁷³ The combination of a turbulent industry and frequent CEO dominance indicates that the technology sector is underachieving against its true potential.

The findings from Tang et al. also discuss dominant CEOs and board activity. This study indicated that a dominant CEO results in extreme firm performance, whether that be positive or negative.¹⁷⁴ The study also indicated that a powerful board is well positioned to reduce the downside risk of a dominant CEO.¹⁷⁵ Thus, a dominant CEO, when paired with a powerful board capable of necessary monitoring, may correlate with higher firm performance. However, whether a dominant CEO and powerful board can remain coupled is uncertain, given the very nature of a dominant CEO. A dominant CEO can be linked to decreased board activity, which leads to less communication and greater information asymmetry. Simply put, a dominant CEO often hampers the flow of information to the board, making it more difficult for the board to retain its power and properly monitor the CEO. Thus, while the study indicated a powerful board and dominant CEO increase firm performance,¹⁷⁶ the realities of CEO dominance make such a coupling effect unlikely long term.

C. *TRADITIONAL GOVERNANCE STRATEGIES ARE INEFFECTIVE IN THE DOMINANT CEO CONTEXT*

As discussed in Sections A and B of this Part, a dominant CEO's presence has a statistically significant effect on overall firm performance. While this performance may be either positive or negative, the difference in firm performance presents an opportunity for governance changes to reduce the negative impacts while retaining some of the benefits. This Section will discuss the challenges associated with this governance problem. Specifically, this Section will note that current trends in governance designed to reduce agency costs and increase effective monitoring may be ineffective because of the dominant CEO's ability to control voting and the director nomination process. As a result, this Section will conclude that more challenging or involved changes, whether through additional governance changes or regulatory action, are necessary to effectively mitigate the negative risks associated with a dominant CEO.

1. Staggered Boards

One of the recent and most successful corporate governance reforms is the removal of staggered director elections in favor of annual director

173. See *supra* Section II.B.2.

174. Tang et al., *supra* note 162, at 1500.

175. *Id.* at 1498–99.

176. See *supra* Section III.A.

elections, where a shareholder vote could oust all directors.¹⁷⁷ In a typical staggered board, shareholders re-elect only a handful of directors in any given year, thus insulating management from a complete board overhaul.¹⁷⁸ Thus, a director will typically serve a two to three-year term before re-election.¹⁷⁹ This inability to replace the entire board in one election prevents a hostile bidder from taking control of the board in one proxy contest.¹⁸⁰ Additionally, research has shown that staggered boards are more prevalent in corporations where the CEO retains greater voting power.¹⁸¹ Studies in the early 2000s indicated that companies with staggered boards performed poorly when compared to those firms with yearly director elections.¹⁸² As a result, shareholders and activists have pushed for the removal of staggered boards.¹⁸³

In the dominant CEO context, staggered boards or full-slate director elections make little difference because the CEO retains voting control in either scenario. Thus, even if directors were up for re-election every year, the CEO would still retain either complete control (where they own 50 percent or more of the voting shares) or primary control (where they own a large block of stock below the 50 percent threshold) over the director's tenure. This control, as discussed above, weakens a director's ability to effectively monitor management's actions. As a result, changing the director replacement procedures would not allow a board to reduce the downside risk of a dominant CEO.

To the contrary, a staggered board, where a director is isolated from the threat of being ousted for a longer period of time, may actually work to encourage further monitoring. While this is counter-intuitive from a shareholder rights perspective, a corporation with a dominant CEO could insulate its directors and encourage more honest and effective oversight by lengthening director terms. However, a staggered board would still require independent, motivated directors that are not beholden to the CEO who nominated them.

177. David F. Larcker & Brian Tayan, *Loosey-Goosey Governance: Four Misunderstood Terms in Corporate Governance* 1–2 (Rock Ctr. for Corp. Governance at Stanford Univ. Closer Look Series: Topics, Issues & Controversies in Corp. Governance No. CGRP-79, 2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3463958 [<https://perma.cc/4899T3LF>]. Between 1998 and 2018, staggered board use by S&P 500 companies dropped from 303 to 56. *Id.* at 9.

178. *Id.* at 1–2.

179. *Id.*

180. *Id.* at 2 (“A staggered board is considered a poor governance choice because it prevents an activist investor from taking majority control of a board in a single election and instead requires two years for a proxy contest to be successful.”).

181. Kosmas Papadopoulos, *CEO Ownership, Corporate Governance, and Company Performance*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 13, 2019), <https://corpgov.law.harvard.edu/2019/05/13/ceo-ownership-corporate-governance-and-company-performance> [<https://perma.cc/6ZZH-EXC2>].

182. Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409, 430 (2005) (“Putting this long-standing question to an empirical test, we find that staggered boards are associated with lower firm value.”).

183. Larcker & Tayan, *supra* note 177, at 2.

2. Requiring a Supermajority of Independent Directors

While exchange rules and regulations require a certain level of board independence, many firms have almost entirely independent directors, with only the CEO as an inside director.¹⁸⁴ Many believe that independent directors are more effective monitors and less beholden to the interests of management.¹⁸⁵

While independent directors may be more effective monitors, the nominating and voting processes, as well as the narrow definitions of independence under Delaware law and exchange rules, make a supermajority alone ineffective. The dominant CEO's ability to control the voting and nominating process ensures that even independent directors will lack the motivation necessary to reduce the downside risks created by a dominant CEO.

3. Summary

As these examples indicate, simple procedural governance changes are unlikely to successfully reduce the risks associated with a dominant CEO. While these measures can effectively improve firm performance without CEO dominance, they remain ineffective because of a dominant CEO's control over the voting and nominating process. Thus, more drastic and substantive measures are necessary to ensure effective governance.

IV. POTENTIAL REFORMS IN THE DOMINANT CEO CONTEXT

The difficulties associated with governance of dominant CEOs, specifically in the turbulent tech sector, cannot be mitigated by traditional corporate governance reform. This Part will analyze several potential options, from the corporation itself, stock exchanges, regulators, and Delaware courts, that may effectively reduce the potential for disastrous negative firm performance caused by CEO dominance, while still allowing the positives associated with such dominance. This Part concludes by arguing that a tighter independence definition is necessary to combat the inherent conflicts that arise when a controlling shareholder is responsible for the hiring, compensating, and potential firing of every member of the board of directors. Additionally, this Part contends that empowering minority shareholders in CEO-dominated corporations, whether through a minimum number of board seats or a required percentage of their vote on certain issues, such as mergers or director elections, would act as a restraint against a dominant CEO.

A. *BAN DUAL CLASS STOCK STRUCTURES*

Potentially the most obvious and drastic solution to the dominant CEO problem is to prohibit all dual class stock structures, making one share-one vote mandatory for all corporations. While this solution does not necessarily

184. KOSMAS PAPADOPOULOU ET AL., INST. S'HOLDER SERVS., U.S. BOARD STUDY: BOARD ACCOUNTABILITY PRACTICES REVIEW 11 (2018).

185. Fairfax, *supra* note 100, at 138–39; Gordon, *supra* note 96, at 1521–22.

end the dominant CEO problem,¹⁸⁶ it removes the most popular method through which tech founders retain de facto control while still benefitting from an IPO.

While attractive for its simplicity and immediate impact, an outright ban of dual class stock structures is problematic for several reasons. First, it is unclear who would regulate the ban. The SEC previously attempted to regulate dual class stock structures, but a court found that the SEC overstepped its authority in this regard.¹⁸⁷ Second, stock exchanges can ban the listing of any company with dual class stock structures, but the competitive market of stock exchanges makes it unlikely that every exchange will voluntarily cede potential business. As long as dual class is legal, there will be an exchange willing to list such corporations in order to make money. Third, an outright ban is overly inclusive because it would remove all firm performance differences, not just those that are negative.

As discussed above, dominant CEOs can add value to corporations in certain situations. The goal of regulators and courts, in the context of a dominant CEO, should be to allow these positive performance externalities while mitigating the risks of disastrous firm performance. A blanket ban does not just mitigate the risk; it obliterates the potential reward in favor of clarity and simplicity. As such, an outright ban of dual class stock structures is not the most effective way to improve dominant CEO governance.

B. DIRECTOR TERM LIMITS

One option that will reduce groupthink bias among directors is limiting the length of time directors are allowed to sit on a board. As discussed above, the longer a member is part of a group, the stronger they believe that group is performing at a high level.¹⁸⁸ This can be problematic in situations where directors are asked to allow derivative lawsuits against fellow directors, including the CEO. By limiting directors' terms, corporations can ensure that new directors—with new ideas—are heard at meetings. Additionally, term limits will potentially lessen a dominant CEO's control over director retention, especially where a director is in their final term. As a result, directors with term limits will feel more empowered to take an active role in monitoring the CEO. The board can also implement term limits through traditional procedural governance, without relying on governmental regulations or court involvement. As such, adding a term limit is likely one of the most practical and efficient ways to reduce a dominant CEO's control over the board.

While easy to implement and effective at reducing some of the inherent biases that exist in all boards, term limits for directors do not eliminate a dominant CEO's control over the nominating and voting process. As such,

186. CEOs could still retain large amounts of power by simply retaining a large percentage of equity in the firm. However, retaining a large equity stake reduces the benefits that stem from an IPO.

187. See *Bus. Roundtable v. SEC*, 905 F.2d 406, 413 (D.C. Cir. 1990).

188. See *supra* Section II.C.3.

more steps are necessary to ensure that a dominant CEO is not consistently making decisions without proper monitoring. For proper monitoring to exist, a board must have sufficient power to not only raise concerns about a given course, but also to correct or change unilateral decisions that it believes impair long-term shareholder value.

Additionally, director term limits lead to brain drain from a corporate board, as the most experienced and knowledgeable directors are forced to leave the company, replaced by outsiders who are just as likely to be beholden to the dominant CEO. This brain drain indiscriminately removes directors who have worked with the CEO and who may, even if in limited circumstances, have the clout to oppose the dominant CEO's actions. As a result of its failure to truly address the problem and its potential reduction in overall board competence, imposing term limits is not a viable solution to curb the power of a dominant CEO.

C. INCREASE REQUIRED INDEPENDENCE IN DOMINANT CEO CORPORATIONS

To improve the board's ability to monitor a dominant CEO, regulators, courts, and stock exchanges should require greater director independence in situations where a CEO or other shareholder is deemed to be controlling. These heightened requirements, whether by shifting the burden of proof or changing the definition of independence, should include greater scrutiny on social ties, in an effort to ensure that directors are not beholden to the CEO. The courts are the best option to uphold this heightened scrutiny, given its competency and recent precedent considering certain social ties.¹⁸⁹

The new inquiry into director independence and its new definition could take several forms. For example, the new definition could scale back the strong language used in *Beam*.¹⁹⁰ Instead of requiring a plaintiff to show that the "director would be more willing to risk his or her reputation than risk the relationship with the interested director,"¹⁹¹ Delaware courts could require a showing that the dominant CEO and the director's relationship rendered the director slightly biased. Such a definition would allow the Delaware courts to consider a whole range of potential conflicts, including job security, compensation, and implicit biases.

Alternatively, Delaware courts could create a presumption against a corporation in cases where a dominant CEO's relationship with a director is at issue. First, a court, using the analysis discussed above, would consider whether the shareholder-CEO was dominant.¹⁹² If the court determines there is a controlling shareholder-CEO within the corporation, the burden of proving the director's impartiality would shift to the corporation. Thus, the corporation would have to affirmatively demonstrate that either (1) the director was sufficiently independent when the decision was made, or (2) that

189. See *supra* Section II.C.2.

190. *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1052 (Del. 2004).

191. *Id.*

192. See *supra* Section II.A.

the transaction at issue was entirely fair to the minority shareholders.¹⁹³ This narrow burden-shifting requires the corporation and the dominant CEO to ensure the board of directors is effectively monitoring the company.

Independence definitions which address social ties would limit the dominant CEO's ability to place close friends and like-minded colleagues on the board. This would diversify the board by introducing viewpoints less in agreement with the CEO, and it would increase the odds that board members would seriously monitor management decisions. Additionally, board members with fewer ties to the CEO may view their role as less self-centered, which could decrease the motivation to simply remain silent and collect compensation. In any event, more independence in the board room, specifically in the dominant CEO context, can reduce bias and ensure directors are more motivated to secure value for all shareholders, not just the dominant CEO. Delaware courts should establish a more thorough analysis of director relationships to ensure proper monitoring by the board of directors.

D. GIVE NON-CEO SHAREHOLDERS BOARD SEATS

In addition to increasing judicial scrutiny of dominant CEO and director relationships, stock exchanges, regulators, and lawmakers should require that minority shareholders be given a real voice on the board by electing a subset of the corporation's directors. By controlling a few seats on the board, the minority shareholders can elect directors, without the oversight of the dominant CEO, who they believe will monitor the corporation and ensure profit maximization. Instead of relying on the dominant CEO's hand-picked board, minority shareholders would be able to directly appoint a minority block of directors who will remain accountable only to their interests. These minority directors, while not directly stripping the dominant CEO of his control, would act as dissenters in situations where the interests differ between the corporation and the dominant CEO.¹⁹⁴ Such dissent, like other non-binding forms of corporate governance,¹⁹⁵ could push a dominant CEO away from certain actions that are not in the minority's best interest.

193. Entire fairness is a standard used by Delaware courts when a transaction does not qualify for the business judgment rule. See *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014), *overruled by* *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754 (Del. 2018) (“[E]ntire fairness is the highest standard of review in corporate law. It is applied in the controller merger context as a substitute for the dual statutory protections of disinterested board and stockholder approval, because both protections are potentially undermined by the influence of the controller.”).

194. See *Bebchuk & Kastiel*, *supra* note 9, at 614 (noting that in certain situations, controlling shareholders have interests that differ from those of minority shareholders).

195. For example, shareholder proposals that are approved by majority vote, while not binding, can ratchet up pressure for the board to take action. See SANFORD LEWIS, SHAREHOLDER PROPOSAL DECISION-MAKING OF THE SECURITIES AND EXCHANGE COMMISSION: ANALYSIS AND RECOMMENDATIONS OF THE SHAREHOLDER RIGHTS GROUP 2 (2018) (“Shareholder proposals are typically non-binding. They offer a flexible mechanism for investors with diverse goals and objectives to request enhanced disclosures and increased accountability of corporate boards and managers regarding emerging, neglected, or systemic long-term risks and opportunities. Many current corporate practices, such as the issuance of sustainability reports, and effective attention

To enact these changes, regulators, lawmakers, and stock exchanges should (1) define what would constitute a dominant or controlling shareholder, and (2) require a minimum percentage of sub-board seats be nominated by and voted on solely by the minority block of shareholders. For example, the NYSE could specify that where a shareholder retains greater than 50 percent of the corporation's voting power, the minority shareholders will directly control no less than 30 percent of the corporation's board seats. Additionally, the SEC or state lawmakers could advance this same rule through similar means.

The concept of awarding shareholders board seats is not unprecedented. In recent years, companies who are targets of hedge fund activists have awarded board seats in settlements to avoid costly and hostile proxy contests.¹⁹⁶ This settlement tactic is used increasingly by companies to appease activist investors. Instead of entering into a costly and uncertain proxy fight, corporations settle with the activist-investor by adding a few (typically two or three) seats to the board and allowing the activist to place their preferred director in those seats.¹⁹⁷ In a similar vein, controlled corporations could require minority shareholders to appoint several directors during each annual meeting. Minority shareholders could appoint directors based on their preferences, or decline, thus allowing the CEO to appoint their preferred directors with approval from those with less power.

This system is beneficial in several respects. First, it gives minority shareholders a direct voice on the board. If corporate performance is suffering or shareholders would prefer a different path, they can select directors that will closely monitor the corporation and push for changes that better maximize firm value for all. On the other hand, shareholders who approve of the CEO's performance can either cede their power to the CEO to allow business as usual, or appoint a director themselves that will ensure the company remains on its current path. In any respect, the benefit of empowering minority shareholders is optimal. This choice reduces the downside risk when necessary and allows the positive firm performance associated when appropriate. In this respect, board seats for minority

to long-term environmental and social risks such as climate change, have been substantially initiated and shaped by shareholder proposals.”).

196. See John C. Coffee, Jr. et al., *Activist Directors and Agency Costs: What Happens When an Activist Director Goes on the Board?* 4–5 (Columbia Bus. Sch. Research Paper No. 18-15, 2018), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3100995 [<https://perma.cc/2N2L-YMK6>] (“First, hedge funds are succeeding in placing their nominees on corporate boards, and in 2016 netted a record 131 board seats for their nominees. Second, the vast majority of these seats were resolved through private agreements” (footnote omitted)). For a recent example, see Svea Herbst-Bayliss & Greg Roumeliotis, *MGM Hands Board Seat to Activist Hedge Fund Corvex's Meister*, REUTERS (Jan. 17, 2019, 8:10 PM), <https://www.reuters.com/article/us-mgm-resorts-intl-corvex/mgm-hands-board-seat-to-activist-hedge-fund-corvexs-meister-idUSKCN1PC04O> [<https://perma.cc/8J53-872A>].

197. See Michael Flaherty & Anjali Athavaley, *U.S. Companies Quicker to Give Board Seats to Activists*, REUTERS (Sept. 25, 2015, 12:11 AM), <https://www.reuters.com/article/us-hedgefunds-activists-insight-idUSKCN0RP0Do20150925> [<https://perma.cc/A6UX-MRYL>].

shareholders encourage effective monitoring without depriving the CEO of the desired voting control.

V. CONCLUSION

CEOs with majority voting power and outsized influence are increasingly operating tech companies. As a result of this dominance, the board of directors are left without the motivation and power necessary to fulfill its role of monitoring management and ensuring that the company is pursuing long-term shareholder value. The dominant tech CEO's ability to nominate, compensate, and retain "independent" directors renders said directors neither truly independent nor free from self-serving or unconscious biases. As a result, the dominant CEO is practically free from oversight, allowing him to pursue strategies that maximize his own private benefits from the corporation.

To eliminate or reduce these agency costs associated with the dominant tech CEO, while allowing certain performance benefits, corporations, regulators, and courts must act to strengthen true board independence and empower effective monitoring. Courts, regulators, and stock exchanges should strengthen board independence requirements and definitions to include social ties. This will prevent dominant CEOs from nominating and approving directors whom they know will not second-guess management decisions. Additionally, providing several seats on the board for minority shareholders could increase both board objectivity and overall monitoring.